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Damage Remedies for Tender Offerors - The Extent of Appropriate Compensation

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Notes

Damage Remedies For Tender Offerors—The Extent of Appropriate Compensation

Introduction

Recent decisions by the Courts of Appeals for the First and Second Circuits[1] have dealt with whether a defeated tender offeror, whose takeover attempt has been thwarted by the fraudulent defensive actions of target management, should be allowed to recover damages from the target corporation itself. Both courts decided to permit an offeror an implied cause of action under section 14(e),[2] the antifraud provision of the recently enacted Williams Act.[3] While both courts elected to permit recovery,[4] a crucial disagreement with respect to the nature of con-

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[1] H.K. Porter Co. v. Nicholson File Co., 353 F. Supp. 153 (D.R.I. 1972), *aff'd* 482 F.2d 421 (1st Cir. 1973), Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973).

[2] 15 U.S.C. § 78n(e) (1970).

> It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security holders in opposition to or in favor of any such offer, request, or invitation. The Commission shall, for the purposes of this subsection, by rules and regulations define, and prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive, or manipulative.

Id.

[3] The Williams amendments also imposed disclosure requirements on offerors, § 14(d)(1), 15 U.S.C. § 78n(d)(1) (1970), and regulation of the targets' defensive actions, § 14(d)(4), 15 U.S.C. § 78n(d)(4), § 13(e)(1), 15 U.S.C. § 78m(e)(1) (1970).

[4] In addition to relying upon the rationale of J.I. Case Co. v. Borak, *see* text accompanying notes 5–8 *infra*, both *Porter* and *Chris-Craft* found justification for their decision to allow damages in the context in which section 14(e) was enacted. *Porter,* 482 F.2d at 424, *Chris-Craft,* 480 F.2d at 358–61.

Rule 10b–5 already covered tender offer transactions, but rights of action under it had been restricted, under the *Birnbaum* doctrine, to "purchasers and sellers." *See* note 27 *infra.* Prior to the passage of the Williams Act, neither a tender offeror nor a target corporation had been allowed to sue under Rule 10b–5. Iroquois Indus. v. Syracuse China Corp., 417 F.2d 963 (2d Cir. 1969). In *Iroquois Industries,* a case with facts strikingly similar to those in *Porter,* the Second Circuit denied a right of action to the tender offeror in a rule 10b–5 action. That court saw the then new, but not yet applicable, section 14(e) as evidence of congressional belief that this particular "gap" in rule 10b–5 coverage existed, thereby strongly implying that section 14(e) was intended to close this "gap."

> The second prong of the (Williams) amendment is § 14(e). In effect this applies rule 10b–5 both to the offeror and to the opposition-very likely, except per-

gressional purpose in this area led to different attitudes towards the extent of such recovery.

The focus upon congressional purpose stems from the very nature of implied causes of action under the federal securities laws and the rationale of *J.I. Case Co. v. Borak.*[5] That decision announced a duty of the federal courts "to be alert to provide such remedies as are necessary to make effective the congressional purpose."[6] The Supreme Court took notice of the limitations on SEC resources, and of the fact that "the possibility of civil damages serves as a most effective weapon in the enforcement of the securities laws,"[7] concluding therefore that private actions are a "necessary supplement to [the Securities and Exchange] Commission action."[8]

The First Circuit, in *H.K. Porter v. Nicholson File Co.,*[9] intimated that the relevant congressional purpose was an overriding concern for target corporation investors, and therefore held "that damages should be denied to . . . the extent they are inconsistent with [the in-

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haps for any bearing it may have on the issue of standing, only a codification of existing law.

Electronic Specialty Co. v. International Control Corp., 409 F.2d 937, 940-41 (2d Cir. 1969).

The *Porter* court also pointed out the important economic stake each contestant has in the takeover bid and their "'symmetrical' statutory obligations," concluding that reciprocal rights of action are "only fair." 482 F.2d at 424. The court was probably influenced by the fact that section 14(e) prohibits misrepresentations in "*opposition to* or in favor of any such tender offer." 15 U.S.C. § 78n(e) (1970) (emphasis added). Moreover, SEC regulations promulgated under the filing and disclosure provisions of the Williams Act impose restrictions and obligations on target management as well as on the offeror. Schedule 13D, 17 C.F.R. § 240.13d-101 (1974) (eff. July 30, 1968), promulgated under the authority given to the SEC by § 13(d)(1), 15 U.S.C. § 78(d)(1) (1970), requires that a disclosure statement be filed by anyone acquiring more than 5 percent of certain equity securities other than pursuant to a tender offer, or by anyone making a tender offer which could result in the offeror holding more than 5 percent of certain equity securities.

The statement must disclose the offeror's name, address, occupation, employment history, and any criminal record for the last ten years. The source and amount of funds to be used, the plans the offeror may have for the target if his offer is successful, his present interest in the target's securities, and any contracts, arrangements, or understandings with any person with respect to the securities of the target must all be disclosed.

The implied cause of action for damages has also been grounded on the common law tort principle of allowing private suits to enforce public legislation by plaintiffs who are within the class of persons intended to be benefited by the statute. *Porter,* 482 F.2d at 424; *Chris-Craft,* 408 F.2d at 360. *See* RESTATEMENT OF TORTS § 286 (1965). And, finally, the strong similarity between the language of section 10(b) and that of section 14(e), coupled with the omission of "purchase and sale" language in the latter, has been relied upon. *Porter,* 482 F.2d at 421; *Chris-Craft,* 480 F.2d at 361; *Electronic Specialty Co.,* 409 F.2d at 941.

[5] 377 U.S. 426 (1964).

[6] *Id.* at 433.

[7] The proposition that imposition of civil damages will deter securities law violations, and that recovery of such damages will encourage vigorous private prosecution of such violations, is referred to in this note as the "incentive-deterrence theory."

[8] 377 U.S. at 432.

[9] 353 F. Supp. 153 (D.R.I. 1972), *aff'd* 482 F.2d 421 (1st Cir. 1973).

vestor protection] purpose."[10] On the other hand, the Second Circuit in *Chris-Craft Industries v. Piper Aircraft Corp.*[11] recognized a broader congressional purpose of insuring the integrity and efficiency of the securities markets, and demonstrated its intention to allow recovery of all provable damages.[12]

This note will suggest that the Second Circuit's decision to allow recovery of all provable damages is the better view. In essence this note contends that the *Chris-Craft* interpretation of congressional purpose is more persuasive, and that the limitations on recovery which *Porter* seems to impose would undercut an investor protection policy.

H.K. Porter Co. v. Nicholson File Co.

In the recent case of *H.K. Porter Co. v. Nicholson File Co.*, the First Circuit raised, but did not resolve, the problem of compensating a tender offeror whose takeover attempt had been thwarted by fraudulent defensive actions by the target's management. The court faced the dilemma after a 1972 attempt by the H. K. Porter Company to gain control of the Nicholson File Company by means of a tender offer. Nicholson's management resisted the takeover attempt with a series of letters to stockholders, press releases, and lawsuits.[13] The tender offer expired with Porter purchasing less than one-third the number of shares it sought. Porter brought suit against Nicholson and the Nicholson directors claiming that Nicholson's defensive activities and statements were fraudulent.[14]

In support of its motion to dismiss, Nicholson argued that it would be an "anomaly" to assess a damage judgment against it since the burden would eventually fall on Nicholson's shareholders.[15] The district court answered by recognizing the existence of another class of protected shareholders: "the shareholders of the tendering [offering] corporation who must ultimately bear the damages suffered by the offeror."[16] On appeal, the First Circuit agreed that an implied cause of action for damages should be permitted under section 14(e). Yet when confronted with the issue of determining damages, the appellate court could only state:

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[10] 482 F.2d at 424.
[11] 480 F.2d 341 (2d Cir. 1973).
[12] *Id.* at 379–80.
[13] 341 F. Supp. 508 (D.R.I. 1972) (motion for preliminary injunction denied, allegations of violations of the Securities Exchange Act of 1934 dismissed).
[14] 353 F. Supp. 153 (D.R.I. 1972).
[15] *Id.* at 165.
[16] *Id.*

> It follows, however from the overriding investor-protection purpose of § 14(e) that damages should be denied to a tender offeror to the extent they are inconsistent with that [investor-protection] purpose.
> . . . We cannot yet know the theory of damages to be established, nor how and to what extent recovery from Nicholson might affect the various Nicholson shareholders (of whom Porter has been one), nor what right of recovery may be available to the other Nicholson stockholders to offset the effect of any corporate loss. . . . Any recovery in damages from the corporation must be consistent with the primary congressional aim of protecting investors, and the district court would be warranted in denying damages, otherwise established, if it should conclude that to award them would be to subvert that purpose.[17]

Chris-Craft Industries v. Piper Aircraft Corporation

The Second Circuit was confronted by the same basic question in *Chris-Craft Industries v. Piper Aircraft Corp.* Yet there is no indication that that court saw any conflict between a congressional purpose of protecting investors and a policy of compensating tender offerors who have been defeated by means of section 14(e) violations. The court awarded substantial damages to a defrauded offeror but made no mention of the effect of such recovery upon the defendant's shareholders.

This case arose from an extended battle for the control of Piper Aircraft Corporation. Chris-Craft Industries attempted to gain control of Piper by means of open market purchases commencing on December 20, 1968, as well as a cash tender offer which occurred shortly thereafter. Piper's management resisted this takeover bid by various means,[18] eventually encouraging the Bangor Punta corporation to launch a rival takeover bid, and agreeing to aid that attempt by selling their 31 percent interest in Piper for a package of Bangor Punta securities.[19] As a result of these acquisitions, open market purchases, and an exchange tender offer, Bangor Punta obtained control (51 percent) of Piper. At the end of the contest, Piper found itself in possession of approximately

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[17] 482 F.2d at 424–25.

The court, despite its concern for the shareholders of the target corporation, allowed the district court ruling that Porter, once it proved liability, could recover damages from the target, to stand. "We do not disturb that ruling now." *Id.* at 425. The *Porter* decision was cited in *Chris-Craft* as authority that an offeror has standing to sue a target corporation for damages resulting from its section 14(e) violations, 480 F.2d at 358, 360.

[18] These included a board resolution that the Chris-Craft offer was not in the best interests of Piper shareholders (mailed to shareholders), letters to shareholders, and a press release announcing a putative agreement on the part of Grumman Aircraft Engineering Corporation to purchase 300,000 shares of Piper, and abortive attempts to increase the number of outstanding Piper shares. 480 F.2d at 349–54.

[19] 480 F.2d at 352–53.

42 percent of outstanding Piper shares, and sued Bangor Punta,[20] for section 14(e) violations.[21]

At first glance, *Chris-Craft* and *Porter* might seem to address two different issues, since *Chris-Craft* allowed the defeated tender offeror damages against a rival, successful, tender offeror, rather than against a target corporation. The target corporation in *Chris-Craft* was found to be "the prize in the battle, not a contender"[22] and no liability was imposed upon it. However, because that successful tender offeror achieved its takeover by means of an exchange offer, after the contest many investors who originally were shareholders of the target corporation found themselves shareholders of the successful offeror, which was held liable for substantial damages.[23]

The fact that *Chris-Craft* dealt with the same basic problem which had perplexed the *Porter* court was recognized in the original district court opinion dismissing Christ-Craft's complaint against all defendants.[24] The district court realized that plaintiff's recovery against the rival offeror in *Chris-Craft* was really no different, in terms of impact on target shareholders, than recovery against the target corporation itself, *i.e.*, the *Porter* situation. Because the defendant in *Chris-Craft*, Bangor Punta, won control by means of an exchange tender offer, "[t]he proximate victims of virtually all the alleged violations . . . are one-time Piper stockholders who now hold Bangor Punta stock. These are the very people against whom Chris-Craft wishes us (by a judgment against their company) to assess many millions of dollars of damage . . . ."[25]

As the district court opinion recognized, to whatever extent one might consider the award of damages to a defeated offeror "anomalous,"[26] the "anomaly" is the same whether damages are awarded in the *Chris-Craft* situation or in the *Porter* situation. It would make no sense to protect target shareholders when they have been tricked into refusing a tender offer and retaining their shares in a section 14(e) corporate defendant, and yet to refuse such protection when they have

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[20] Other defendants included members of the target's management (referred to as the Piper family), members of the successful offeror's management, and First Boston Corporation, the underwriter of the successful offer, with members of its management.

[21] 480 F.2d at 354.

[22] 480 F.2d at 379 n.34.

[23] Damages awarded the plaintiff by the trial court were $1,673,988. Chris-Craft Indus. v. Piper Aircraft Corp., 384 F. Supp. 507 (S.D.N.Y. 1974). On appeal, damages were measured anew at $25,793,365. 516 F.2d 172 (2d Cir. 1975).

[24] 337 F. Supp. 1128, 1146 (S.D.N.Y. 1971).

[25] *Id.*

[26] ". . . [N]either reason nor justice would permit such a result." *Id.*

been tricked into exchanging their shares with those of a section 14(e) defendant. The converse would be just as illogical. Given its conviction that section 14(e) was intended to promote the general integrity and efficiency of the securities markets it is likely that the *Chris-Craft* court will be as willing to assess compensatory damages against a target corporation when a case such as *Porter* comes before it.

Effectiveness of Permitting Recovery from the Target

In both *Porter* and *Chris-Craft,* the judicial decision to allow an implied cause of action for a defeated offeror against a target corporation depended upon an analogy to implied causes of action under rule 10b-5,[27] and therefore upon the mandate in *J. I. Case Co. v. Borak* that "it is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose."[28] Whatever reservations it had with respect to the extent of recovery, even the *Porter* court thought that allowing the offeror to act as a private attorney general could serve as a useful supplement to the limited enforcement resources of the SEC. The effectiveness of private enforcement is therefore crucial to the basic rationale for allowing recovery from the target corporation. More specifically, it must be determined whether the right to recover damages[29] from the target is an effective and necessary addi-

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[27] 17 C.F.R. § 240.10b–5 (1974). Rule 10b–5 is the broad antifraud provision of the federal securities regulations. It was promulgated by the SEC under the authority granted by section 10(b) of the 1934 Act. 15 U.S.C. § 78j(b) (1970). The scope of rule 10b–5 has been expanded by imposing liability for "mere negligence." *See generally* Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341, 363 (2d Cir. 1973), *cert. denied,* 414 U.S. 910 (1973); Mitchell v. Texas Gulf Sulfur Co., 446 F.2d 90, 102 (10th Cir. 1971); SEC v. Texas Gulf Sulfur Co., 401 F.2d 833 (2d Cir. 1968), *cert. denied,* 394 U.S. 976 (1969); List v. Fashion Park, Inc., 340 F.2d 457 (2d Cir. 1965), *cert. denied,* 383 U.S. 811 (1965). Standards of causation have also been relaxed. *See generally* Affiliated Ute Citizens v. United States, 406 U.S. 128 (1972); Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970); Chris-Craft Indus. v. Piper Aircraft Corp., 480 F.2d 341 (2d Cir. 1973), *cert. denied,* 414 U.S. 910 (1973).

It is generally true that a plaintiff must be a purchaser or seller of securities in order to be granted an implied cause of action under section 10(b) and rule 10b–5, a theory commonly known as the *Birnbaum* doctrine. *See* Blue Chip Stamps v. Manor Drug Stores, —— U.S. ——, 95 S.Ct 1917 (1975); Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952).

For policy reasons, courts have used the *Birnbaum* doctrine to retain some limits on rule 10b–5 actions. "That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges." Iroquois Indus. v. Syracuse China Corp., 417 F.2d 963, 969 (2d Cir. 1969) (rule 10b–5); *see also* Greenstein v. Paul, 400 F.2d 580 (2d Cir. 1968); Washburn v. Madison Square Garden Corp., 340 F. Supp. 504 (S.D.N.Y. 1972).

[28] 377 U.S. at 426 (1964).

[29] Injunctive relief alone is clearly inadequate because a target may defend against an offer by means of secret market manipulation, or by statements which will not be known to have been deceptive until the contest is over, and because of the vital importance of speed in a tender offer takeover attempt.

tion to the undisputed right to sue the target's officers and directors as individual defendants.[30]

First of all, the shareholders of the target corporation might argue that there would be no additional deterrent effect to be gained by assessing damages against the corporation.[31] If the target's directors and executives cannot be deterred by the threat of a damage action brought against themselves, it is perhaps unlikely that they will be deterred by the threat of a law suit against the corporation. Imposing such a burden on innocent shareholders would be more difficult to justify if a court was convinced that officers and directors do not care, or care little, about a damage judgment that in fact will be satisfied by the shareholders.

But surely this is too cynical. It does not seem likely that the average executive is so lost to decency that he cares nothing about the enterprise entrusted to his care. In any event, an executive's career depends upon the fate of the corporation and upon his competence in running its affairs,[32] including keeping it out of lawsuits. Moreover, executives commonly own stock or stock options in their respective corporations. Thus on balance the prospect of a suit against the corporation itself should have a deterrent effect.

Because of the important personal stake the incumbent management of the target has in the contest, defensive tactics which involve section 14(e) violations probably do not appear as morally reprehensible as in the typical fraud case and can usually be rationalized as being "in the corporate interest." Indeed, because of the magnitude of the stakes in the tender offer situation, the temptation to violate the antifraud provisions is greater than in the ordinary purchase or sale of securities, thus making the strict enforcement of those provisions even more necessary than usual.[33]

The possibility that officers and directors ordered to pay damages for section 14(e) violations may be compensated through either indemnification or insurance[34] provides an additional reason for permitting

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[30] "Recovery from the individual defendants is, of course, on a different footing. The individual defendants have not yet advanced any good reason why they should not be accountable in damages for illegal action, if any." *Porter*, 482 F.2d at 425.

[31] In both *Porter* and *Chris-Craft*, officers and directors were joined as defendants.

[32] An exception might be the outside director who owns little or no target stock.

[33] Note, 19 VILL. L. REV. 671, 680 (1974).

[34] *See generally* G. WASHINGTON & J. BISHOP, INDEMNIFYING THE CORPORATE EXECUTIVE (1963); Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078 (1968); Note, *Indemnification of Directors: The Problems Posed by Federal Securities and Antitrust Legislation*, 76 HARV. L. REV. 1403 (1963); Note, *Indemnifying Corporate Officials for Williams Act Violations*, 50 IND. L.J. 826 (1975).

recovery from the target. If an officer or director will be indemnified, any distinction between suing the individual and suing the corporation disappears. Moreover, the basic rationale for permitting any recovery is the hope of deterring violations on the part of target executives in future tender offers. If such individuals know that insurance or indemnification will cover any damage judgments against themselves, the only deterrent effect to be hoped for lies in the threat of additional recovery against their corporations. While executives and directors probably are concerned about the welfare of their firm, to some extent the effectiveness of deterrence depends on the likelihood that target shareholders will impose sanctions on officers and directors who cause their corporation to pay heavy civil damages. For this reason, in every situation where damages will ultimately be paid by the corporation, a court should make clear to the shareholders just what is happening and who is paying.

Finally, an argument that there is nothing to be gained by permitting recovery of damages against the target also disregards the incentive side of the incentive-deterrence theory. In shaping damage remedies, courts should also keep in mind the importance of providing the necessary incentive for vigorous private prosecution of section 14(e) violations. Unless it will be worth the trouble to sue for damages (keeping in mind the heavy litigation expenses involved), the offeror will find little incentive to seek anything other than pre-injury injunctive relief. Corporate executives are well paid, but not many could pay the kind of damages likely to be involved in a suit of this kind.[35]

On balance it would appear that a cause of action for damages by the defeated tender offeror against the target corporation can be an effective tool for enforcement of federal securities legislation, both as a deterrent to section 14(e) violations and as an incentive for private prosecution of such violations. However, as will later become apparent, the effectiveness of employing offerors as private attorneys general will depend on the extent and predictability of the damage recovery.

Porter and "Investor Protection"

Because of its primary concern for the protection of target investors[36] the First Circuit announced in *Porter* that a court "would be war-

[35] The plaintiff in Chris-Craft Indus. v. Piper Aircraft Corp. was awarded $25,793,365.00, and that in a case where it was held that the plaintiff-offeror had lost, not "control," but only its "opportunity to gain control." Chris-Craft failed to establish that it could have succeeded in obtaining enough shares to give it control. 480 F.2d at 373, 378–79.

[36] A subsidiary problem with the *Porter* court's concern for investor protection is that it embraces only target shareholders. It is inconsistent to perceive the target corporation

ranted in denying damages, otherwise established, if it should conclude that to award them would be to subvert [the investor protection] purpose" of the statute, and that "damages should be denied to the extent they are inconsistent with that purpose."[37] The court's directive to the district court invites speculation as to what theory of damages could qualify.[38] This approach also raises the question of the probable effect of such a computation of damages on the original incentive-deterrence rationale of private damage suits, and of whether a policy of fully compensating plaintiff-offerors would really be inimical to the interests of target shareholders.

Computation of Damages

The *Porter* court did not explain the measure of damages which the district court was to apply. However, two possible tests suggest themselves. The *Porter* court's directive would apparently allow the offeror some recovery from the target, but the amount of the damages either (1) must not be excessive, or (2) must meet, but not exceed, a threshold of sufficiency. Neither approach would be practical.

The "not excessive" test suggests that the meaning of *Porter* is that the calculation of damages should minimize harm to the defendant corporation and its shareholders by simply keeping the recovery of damages per share, or per shareholder, below some unacceptable level. The duty of the district court would therefore be to derive this level of acceptability for its damage judgment from some sort of calculus involving the number of shareholders, the size and financial health of the

as a group of individual, innocent shareholders, while seeing the defeated offeror only as "another of the rival management or control groups jockeying for power." 482 F.2d at 424. A tender offer is a very expensive undertaking; if it is unsuccessful because of a target's section 14(e) violations, a considerable loss will result. If the offeror is not compensated for this loss, the burden must necessarily be borne by its innocent shareholders.

There is authority that the offeror's shareholders are a "protected class" and therefore have standing to sue under section 14(e). In Dyer v. Eastern Trust & Banking Co., 336 F. Supp. 890 (D. Me. 1971) (suit against the offeror), the court wrote: "[T]he purpose of Congress in enacting section 14(e) was to protect the investing public from harm caused by misleading tender offers. Shareholders of the offeror are plainly within the class for whom such protection was designed." *Id.* at 914.

[37] 482 F.2d at 425. The court also stated that "[w]e cannot yet know . . . what right of recovery may be available to the other Nicholson [target] stockholders to offset the effect of any corporate loss." *Id.* Forcing a target to compensate its shareholders for the diminution in the value of their shares which will result from such a judgment would be desirable, but only feasible where the number of these "innocent" shareholders is relatively small.

[38] At the outset it should be noted that framing the issue in terms of determining "the probable impact of recovery from Nicholson [the target] on its shareholders" begs the question. 482 F.2d at 425. If a 14(e) violation by the target has caused damage to the offeror corporation and thus to its shareholders, then one group of shareholders will have to bear the loss. The issue should be which group of shareholders will bear what proportion of the loss which has already occurred.

target, and the actual losses of the offeror. Under this analysis the larger and more prosperous the target corporation, the larger the number of its shareholders, the greater would be the acceptable damages.

Aside from the rather speculative nature of any such inquiry, and the fact that it would seem remarkable to calculate damages in a civil action on the basis of what is essentially an "ability to pay" system, there is no reason to believe that such a system would produce results that promote the policies underlying civil suits in the first place. The result would correspond neither to the damages suffered by the defeated offeror nor, and perhaps more importantly, to the litigation expenses involved in a suit of this kind. The original idea was to encourage vigorous enforcement of the securities regulations by private parties, but under this test, the only such litigation would be against those corporate defendants large and financially healthy enough to "qualify." The weaker the financial condition of a corporation, the less its management would have to fear when contemplating section 14(e) violations during a takeover battle—though the shaky condition of the target may have been the result of their mismanagement.

Besides the "not excessive" test for damages discussed above, another possibility is "threshold sufficiency." *Porter* could mean that the district court is to arrive at that amount of damages which is just large enough to encourage vigorous litigation by defrauded tender offerors but no more. If the only concern is the incentive-deterrence goal this theory may be an ideal compromise under the rationale of the *Porter* court. However, the difficulty of arriving at such a figure in an individual case is clear; the problem of establishing a predictable formula for figuring a "threshold of sufficiency" which will provoke vigorous prosecution of future violations is even more imposing.

The *Porter* court said that they could not "yet know the theory of damages to be established."[39] However, under the two possible approaches to *Porter* discussed above, damages would be so speculative and unpredictable as to jeopardize the original incentive-deterrence policy. Damages should be either granted or denied on the basis of clear and predictable criteria.

The Relationship Between the Interests of Target Shareholders And a Policy of Allowing Recovery of all Provable Damages

The *Porter* court declined to specify a theory of damages because of its concern for the impact on target shareholders. What this approach

[39] 482 F.2d at 425.

seems to ignore is the fact that target shareholders have as much to fear from section 14(e) violations on the part of their incumbent officers and directors as from an offeror's violations.

Where a target's management has successfully defeated a takeover bid by means of a section 14(e) violation, the target's remaining shareholders can be divided into two classes:[40] first, those who either unsuccessfully tendered or, but for the section 14(e) violations, would have tendered and, second, those who would have chosen to keep their shares regardless of whether they had known the truth. In this situation, at least the first group and quite possibly the second, has been injured by the target management's[41] misrepresentations.

Members of the first group, those who either unsuccessfully tendered their shares or, but for the target's misrepresentation, would have tendered, have lost, at a minimum, the premium over current market price which that offer almost certainly included.[42] This group also suffers the detriment of being "locked" into their holdings in the target. Regardless of the outcome of the tender offer, the market price of the target's share tends to stay depressed for a fairly long period of time.[43] Consequently, these shareholders are left with the unenviable choice of either selling out at a loss consisting of both the decline in market value and the premium they would have received, or of keeping their shares in a corporation whose management is negligent and quite possibly incompetent or dishonest. Moreover, these shareholders may very well have been disenchanted even before the takover contest, since indifferent earnings and dividends performance, and a history of poor shareholder

[40] These two classes are not entirely distinct. Most tender offers are conditioned on the tender of a specified number of shares. If the number of tendered shares does not equal the number required, the offeror has often reserved the right to purchase all, a part, or none of the shares actually tendered. Some shareholders may tender only a part of their holdings. Others may tender their entire holdings. Because of the pro-rata takeup requirements of the Williams Act, if more shares are tendered than accepted, every tendering shareholder will still own stock in the target. 15 U.S.C. § 78n(d)(6) (1970). If the section 14(e) violations have been so effective that at the time of expiration of the offer, the offeror feels he has little chance of success, he may opt to return all the tendered shares.

In any event, shareholders who sought to tender, or would have tendered, retain their status as shareholders of the target corporation. Their only safe approach is to deal with arbitrageurs, eliminating the risk but diminishing their gain.

[41] This discussion does not deal with the motivations and interests of shareholders who were directors and officers guilty of the misconduct in question. Ironically, these individuals may have sold their stock in the target to the offeror while discouraging their fellow stockholders from doing the same.

[42] Premiums have been found to represent a bonus over the current market price of as much as 44 percent with a median of 16 percent over market—a considerable loss, especially if a shareholder has sizable holdings. Hayes & Taussig, *Tactics of Cash Takeover Bids*, 45 HARV. BUS. REV. 135, 139-40 (Mar.-Apr. 1967).

[43] *Id.* at 147.

relations, are factors for which potential tender offerors look when evaluating possible targets.[44]

The interests of the second class of shareholders, those who would have chosen to hold their shares regardless of what management did or did not say, may very well have been harmed as well. Of course, it is possible that some members of this class simply preferred the incumbent management to the offeror, that they were not influenced by the truth or falsity of statements made during the takeover fight, and are quite satisfied with the failure of the takeover bid. Some members of this class, however, could have decided to retain some or all of their shares *because* they were dissatisfied with incumbent management, yet desired to keep their interest in the enterprise itself (in which they still had faith) in the hope that the tender offer would succeed and in the belief that the offeror could better manage the target corporation.[45] These shareholders, as a result of section 14(e) violations, are also "locked" into their holdings.

It is certainly true that the Williams Act was intended to benefit target shareholders.[46] When adhered to by both sides of a takeover battle, it will provide the target shareholders with time, information and freedom from misrepresentation. The Act will thereby better enable the

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[44] The simple fact that an attacking group exists is not in itself an adequate reason for a tender offer; a basic dissatisfaction among the shareholders with the company's performance—due to the short comings of the present management or the events beyond its control—must be present before an opposition force can hope to conduct a successful tender offer.

D. Austin & J. Fishman, Corporations in Conflict 3 (1970) [hereinafter cited as Austin & Fishman].

[45] Swanson, *S. 510 and the Regulation of Cash Tender Offers: Distinguishing St. George from the Dragon,* 5 Harv. J. Legis. 431, 472 (1968).

[46] *See generally* Note, *Tender Offers: An Analysis of the Early Development of Standing to Sue Under Section 14(e),* 5 Texas Tech. L. Rev. 779 (1974); Note, *Tender Offers: The Liberalization of Standing Requirements Under Section 14(e),* 7 U.S.F.L. Rev. 561 (1972).

Though the perceived need for protection of incumbent management was probably the reason for the introduction of the Williams Act, it seems clear that Congress came to see the tender offer as a socially useful and legitimate business device. Even in his speech introducing the bill, Senator Williams recognized that an abrupt change of management may at times be a good thing for a corporation. 113 Cong. Rec. 854 (1967). The most important substantive change in the bill was the elimination of a requirement of advance notice to the target itself. This change preserved for future offerors the element of surprise, which has been described as the one essential requirement for a successful tender offer. Austin & Fishman at 35–36. The courts have generally accepted "investor protection" as the purpose behind the Williams Act. *See, e.g.,* Smallwood v. Pearl Brewing Co., 489 F.2d 579, 597 (5th Cir. 1974); H.K. Porter Co. v. Nicholson Fire Co., 482 F.2d 421, 424 (1st Cir. 1973); Electronic Specialty Co. v. International Controls Corp., 409 F.2d 937, 947 (2nd Cir. 1969); Ronson Corp. v. Liquifin Aktiengesellschaft, 370 F. Supp. 597, 601 (D.N.J. 1974). Though they have disagreed as to what that term means, courts have pretty clearly rejected the notion that the statute was meant to protect incumbent management.

target shareholder to deal rationally with the decision confronting him in a tender offer. It is by performing this function that the Act protects target investors. Because this policy is jeopardized by every violation of section 14(e), whether by a target or an offeror, civil damages should be allowed against either. The interests of target shareholders in general will be furthered by vigorous enforcement of section 14(e), yet by refusing to delineate a clear and predictable theory of damages, *Porter* undercut both the deterrent and the incentive effect of the damage remedy.

CHRIS-CRAFT AND THE INTEGRITY OF THE SECURITIES MARKETS

The *Porter* court's concern with the impact of damage liability on the target's shareholders implies that "investor protection" was the only value meant to be furthered by the Williams Act. But besides the interests of "protected investors," however defined, the Williams Act can also be viewed as serving more general social and economic policies. It protects the interest of the investing public, and indeed of the entire country, in fair and honest dealings within the securities market.

The Second Circuit in *Chris-Craft* concluded that the interests of private citizens, even members of a "protected class," must necessarily be subordinated to the broader congressional purpose of insuring the integrity and efficiency of the securities markets:

> Obviously Congress was concerned about the plight of the average public investor who is at a serious disadvantage in dealing with persons possessing superior knowledge, skill and resources. But the public in the role of investors is only part of the picture. The integrity and efficiency of the securities markets are even more important since our entire economy is dependent upon these markets. The securities market performs the essential function of assessing the value that society places upon the efforts of a particular enterprise so that society can obtain the maximum amount of its preferred goods and services that our resources can produce. . . . Considering the weightly interests at stake Congress and the courts justifiably have outlawed all unfair and deceptive practices related to the trading of securities and have encouraged private damage actions to implement the enforcement of the federal securities laws.[47]

[47] 480 F.2d at 357. Judge Timbers cites an article which found four ways in which the value of a corporation's stock effects the amount of available resources which will be allocated to that enterprise. A corporation will be adversely affected by the under valuation of its stock because it cannot sell new equity securities at a higher price, because if it uses market values when selling debt securities its ability to use "leverage" will be diminished, because any stock-for-stock merger or acquisition will be more costly, and because it will be at a competitive disadvantage when trying to attract executive personnel with compensation in the form of stock options. Crossland & James argued that the 1934 Act's

The implication of the *Chris-Craft* interpretation[48] of congressional purpose is clear. If this broader congressional purpose of safeguarding the integrity of the securities markets is recognized, an award of fully compensatory damages to an offeror defeated by means of section 14(e) violations is appropriate, even though the burden must fall on the target shareholder.[49] Although apparently no court in the First Circuit has

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goal of "fair and honest markets" will cause resources to flow to those companies which will make the most efficient use of them. Crossland & James, *The Gods of the Market Place: An Examination of the Regulation of the Securities Business*, 48 B.U.L. REV. 515, 518 (1968).

In a concurring opinion in *Chris-Craft*, Judge Gurfine, although he agreed that private suits for violation of the antifraud provisions of the securities laws should be encouraged, believed that ". . . it is unrealistic and fanciful to suggest that through such suits society can obtain the maximum amount of goods and services that our resources can produce." He noted that honesty and efficiency do not always go hand in hand, that ". . . bankruptcies of honest entrepreneurs are all too common." 480 F.2d at 379. Judge Gurfine perhaps misstates the argument. Even an honest tender offeror may prove an inept manager, but there is at least something to the argument that fraud and deception can hurt the proper distribution of resources in the economy. In a case like *Porter*, the result, of course, is that the old management stays and, as Senator Williams was at pains to acknowledge, target management is sometimes inefficient. In some instances a change of management will be helpful; in the rare case it may even be necessary for corporate survival. Speech by Senator Williams, 111 CONG. REC. 28257, Oct. 22, 1965.

Target corporations tend to have undervalued stock. Low price/earnings ratios have been found to be their most common characteristic. E. ARRANOW & H. EINHORN, TENDER OFFERS FOR CORPORATE CONTROL 2–4 (1970). An analysis of target firms from 1956 to 1965 found poor sales and earnings performances and below average, dividends to be major factors. *See* AUSTIN & FISHMAN at 57. At least from a shareholder's point of view this is not producing the "maximum amount of goods and services." There is, of course, no guaranty that any individual offeror will do a better job. *See* AUSTIN & FISHMAN 75–94. Most firms still in existence after tender offers were in the same relative financial position since the bid, but of those which did change, more improved performance than worsened performance. AUSTIN & FISHMAN at 94. A belief that, on average, they will prove at least marginally better managers can be read into the congressional decision to preserve the tender offer as a viable tool for transfer of control. There can be no denying the possibilities of abuse even after the Williams Act. *See* Brudney & Chirelstein, *Fair Shares in Corporate Mergers and Takeovers*, 88 HARV. L. REV. 297, 336–44 (1974); Brudney, *A Note on Chilling Tender Solicitations*, 21 RUTGERS L. REV. 609, 610–11 (1967). But Congress was informed of these dangers, and despite the fears of many that the Williams Act would spell the end of tender offers, or at least make it much more difficult, decided not to outlaw tender offers, in form or in effect. For pre-Williams Act discussion of what regulation would do to the tender offer device, *see generally* Brudney, *A Note on Chilling Tender Solicitations*, 21 RUTGERS L. REV. 609 (1967); Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965); Manne, *Cash Tender Offers for Shares—A Reply to Chairman Cohen*, 1967 DUKE L.J. 231.

48 Indeed, Chris-Craft's interpretation of legislative purpose gains added credibility in light of the legislative history of securities regulation. Section 14(e) is, after all, an amendment to the Securities Act of 1934, which was motivated not only by the plight of individual investors but also by the then catastrophic condition of the entire economy. At that time, Congress believed that fraud and deception in the securities market had an adverse effect upon public confidence in the economy and therefore upon the economy itself. *See* 15 U.S.C. § 78b (1970) ("Necessity for Regulation").

49 It seems clear that punitive damages will not be imposed in suits arising from implied causes of action under the 1934 Act. *See* Globus v. Law Res. Serv., Inc., 418 F.2d 1276 (2d Cir. 1969); Green v. Wolf Corp., 406 F.2d 291 (2d Cir. 1968); Myzel v. Fields, 386 F.2d 718 (8th Cir. 1967); Securities Exchange Act of 1934, 15 U.S.C. § 78bb(a)

yet had to effectuate the *Porter* decision in an actual award of damages, essentially the same problem has been dealt with by the Second Circuit in *Chris-Craft.*

The Second Circuit had originally remanded the case to the district court on the issue of damages, directing that "[t]he measure of damages should be the reduction in the appraisal value of CCI's Piper holdings attributable to BPC's taking a majority position and reducing CCI to a minority position, and thus being able to compel a merger at any time."[50] The district court attempted to value the "premium" for Chris-Craft's opportunity to gain control, its "lead position."[51] Finding this "well nigh an impossible task,"[52] the court established the fair market value of the shares by an average of the computations of expert witnesses, and awarded 5 percent of that amount.[53]

On appeal, the Second Circuit substituted its own rather more generous measure of damages for that originally reached by the district court. The appropriate measure of damages was held to be the difference between the price Chris-Craft paid for the target stock and the price at which it could have sold those shares after its rival, Bangor Punta, achieved control.[54] Basing computation of damages on the price Chris-Craft had paid for its target stock had been previously rejected by the district court on the grounds that the amounts paid were "wildly and artificially inflated due to the emotional, as well as actual struggle of the parties."[55] However, the appellate court concluded that

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(1970). *See also* Comment, *Remedies for Defrauded Tender Offerors Under Section 14(e) of the Securities Exchange Act of 1934,* 62 GEO. L.J. 1963, 1715–17 (1974); Comment, *The Availability of Punitive Damages for Express and Implied Causes of Action Under the Securities Act of 1933 and the Securities Exchange Act of 1934,* TEMP. L.Q. 140 (1970). *Contra,* de Haas v. Empire Petroleum Co., 302 F. Supp. 647 (D. Colo. 1969); Hect v. Harris, Upham & Co., 283 F. Supp. 417 (N.D. Cal. 1968). It is possible that a court would feel justified in refusing to award damages when a damage remedy would do more than shift a loss, for example in a suit by an offeror which, despite the "failure" of its offer, has made a profit on the shares it purchased. *But see* Dugan & Fairfield, *Chris-Craft Corp. v. Piper Aircraft: Liability in the Context of a Tender Offer,* 35 OHIO ST. L.J. 412 (1974).

[50] 480 F.2d at 380.

[51] 384 F. Supp. 507, 515–23.

[52] *Id.* at 514.

[53] *Id.* at 515–23.

[54] 516 F.2d at 185. Judge Timbers, writing for the appellate court, explained that the district court had erred, first, by failing to recognize a reduction in the value of Chris-Crafts Industries' holdings (41 percent of Piper) when Bangor Punta obtained a majority, and second, by basing its valuation on an anonymous 100 share block of stock, thus failing to recognize the illiquid nature of Chris-Craft's nearly 700,000 share block. 516 F.2d at 183. The Second Circuit affirmed that part of the district court's decision which implemented their earlier directive to include injunctive relief in any judgment. The district court enjoined Bangor Punta from voting its shares for five years from the date of judgment. The lower court also ordered rescinded all changes made in the target's bylaws since Bangor Punta had obtained a majority position. The bylaws, size of the board, and corporate charter are to remain unchanged unless both Christ-Craft and Bangor Punta mutually

> the prices paid in the battle for control of Piper represented what astute businessmen, competing in a fair market, thought potentially controlling blocks of Piper were worth. . . . [They are] more realistic and persuasive indicators of value than experts' 'conceptual appraisals' . . .[56]

The price which a tender offeror was willing to pay for target shares does represent a convenient and informed opinion as to what these shares were worth. The offeror will usually be sophisticated, knowledgeable, and highly motivated to be accurate. He will take care that his offered price will be neither so stingy that it will fail to attract enough shares, nor so generous that it will attract a significant surplus of shares. When an offer attracts more shares than needed, the offeror knows that he is paying more than necessary for the shares taken up.

This approach should markedly aid the private enforcement of the Williams Act. The method used is easy to apply and offers defeated offerors fairly certain and adequate compensation for their losses if they can prove section 14(e) violations. Predictability of substantial recovery will supply the needed incentive for tender offerors to undertake vigorous litigation, and therefore in turn act as a deterrent to fraudulent and manipulative practices by target management.[57]

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agree to a change, or unless the court orders a change. Similarly, there may be no change in the number of the target's outstanding securities, nor any merger, dissolution, or liquidation of Piper without court order. 384 F. Supp. at 523-26.

[55] 384 F. Supp. at 515 n.8.

[56] 516 F.2d at 185-86.

[57] Shares purchased even in an unsuccessful offer may turn out to be a good investment. A theory of damages based on the price paid for shares might therefore be objected to on the grounds that this would occasionally permit an offeror to speculate in the target's stock with the target bearing the risks. Most tender offers are conditioned on the tender of a specified number of shares. If the number of shares tendered does not equal the number required, the offeror has often reserved the right to purchase, at his option, all, a part, or none of the tendered shares. If an offeror voluntarily decides to take up tendered shares, after his takeover bid has obviously failed, a court should be reluctant to make the target corporation a virtual insurer of this new investment, even if it has violated the securities laws. Awarding such damages in this situation would be unjustified, but the possibility of such speculation cannot justify abandonment of this theory of damages because the motive of an offeror at the time he takes up shares would not be incapable of later ascertainment. Doubts should again be resolved against the wrongdoer. *See* note 59 *infra.* It would be a mistake to force offerors who become aware of target section 14(e) violations to choose between continuing the takeover battle in good faith at the cost of giving up any chance of suing for damages if the attempt fails or abandoning the struggle in order to sue immediately. "A victim of a securities fraud does not have to elect between pursuing his goal in spite of the unlawful tactics of his opponents and recovery of damages for injuries sustained." *Chris-Craft Indus.*, 480 F.2d at 376.

If the offeror has not made his offer contingent on the tender of a specified number of shares, courts should not feel reluctant to award damages based on his price on the grounds that the offeror could have included such a condition. Such conditions are reflected in the price offered. *See* AUSTIN & FISHMAN at 183, 191. If a tender offer fails because of target fraud, courts should not in effect punish the offeror for failing to in-

The only area of potential difficulty is the valuation of the offeror's holdings, but this valuation problem seems no more difficult than many routinely dealt with by the federal courts. The appellate court in *Chris-Craft* made use of a hypothetical public offering at the "earliest realistic date" after the battle for control was over.[58] In any event, potential plaintiffs need have no fears on this question since the court on principle resolved doubts and uncertainties against the wrongdoer.[59]

CONCLUSION

Investor protection, one of the purposes behind section 14(e), should encompass the interests of all shareholders, those of the offeror as well as those of the target. The offeror should not be denied its provable damages out of concern for a single class of investors because a cause of action for damages in favor of an offeror would, in the long run, promote the interests of all investors. Moreover, it will also further the second, broader legislative purpose of maintaining the integrity of the securities markets.

A damage remedy for tender offerors can be an important tool for the enforcement of section 14(e). However, its effectiveness will depend on the extent and predictability of damage recovery. Because the apparent effect of the *Porter* decision undercuts the effectiveness of this enforcement device by denying its "private attorneys general" a predictably adequate theory of recovery, that decision is no vindication of legislative intent, but rather a contravention of both statutory purposes enumerated above.

A more fruitful approach is the Second Circuit's decision on liability and damages in *Chris-Craft.* The court awarded a tender offeror who "did not lose in a fair battle,"[60] a fully compensatory damage recovery against a rival tender offeror who "obtained control through its violations of the securities laws."[61] The next step in furtherance of the overriding policies of the securities laws is to hold liable for damages one who has maintained control through violations of the securities laws. The predictability and adequacy of the theory of damages set forth in

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clude such conditions in his offer. An offeror can expect no judicial protection from normal business risks, but securities law violations are not a risk against which even a "corporate raider" should be expected to self-insure by paying a higher price.

[58] 516 F.2d at 188-89. The court accepted the estimate of the plaintiff's expert witness.

[59] *Id.* at 189-90, *citing* Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970); Bigelow v. RKO Radio Pictures Inc., 327 U.S. 251 (1946); and the court's earlier decision in the case, 480 F.2d at 375.

[60] 480 F.2d at 373.

[61] 516 F.2d at 187.

Chris-Craft will act as both a deterrent to section 14(e) violations, and as a powerful incentive to the vigorous private prosecution of such violations.

RANDALL J. NYE